

**LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS**

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FISCAL IMPACT STATEMENT

LS 6335

BILL NUMBER: SB 26

DATE PREPARED: Nov 8, 2001

BILL AMENDED:

SUBJECT: Elimination of Inheritance Tax.

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**FUNDS AFFECTED: X GENERAL
DEDICATED
FEDERAL**

IMPACT: State & Local

Summary of Legislation: The bill provides that the state Inheritance Tax does not apply to property interest transfers from the estate of a person who dies after June 30, 2002. The bill also amends the Indiana Estate Tax formula and provides that the amended formula applies to the estate of a person who dies after June 30, 2002, and before January 1, 2005. It also repeals the Inheritance Tax effective July 1, 2004, and makes conforming amendments.

Effective Date: July 1, 2002.

Explanation of State Expenditures: *Department of State Revenue:* Once the Inheritance Tax is repealed, there could be a savings to the state from a reduction in staff in the Inheritance Tax Section of the Department of State Revenue. The October 2, 2001, state manning table indicates that the Inheritance Tax Section has 15 full-time employees and one part-time employee. The annual salary cost for these employees is \$464,334. Since staff members would still be needed to process returns, a specific savings due to staff reductions could not be estimated.

County Inheritance Tax Replacement: In addition to eliminating Inheritance Tax revenue to the state, the bill would eliminate the resident Inheritance Tax revenue retained by the counties. The annual revenue loss to counties is estimated to be approximately \$11.4 M statewide beginning in FY 2004. As a result of the revenue loss, the bill would increase expenditures from the state General Fund relating to the Inheritance Tax replacement for counties. The maximum amount of county replacement for any year is approximately \$7.5 M. With the repeal of the Inheritance Tax, this amount would continue to be paid to the counties. The estimates are based on the Revenue Technical Committee's FY 2003 forecast (April 12, 2001) for the Inheritance Tax and assumes that revenue will remain the same in subsequent years. The estimates will be updated once a FY 2004 forecast is available. Since the Inheritance Tax does not have to be paid until a maximum of 12 months after the decedent's death (within 9 months of the date of death to receive the 5% early payment discount), the impact of the bill is not expected to begin until FY 2004. (See Explanation of

Local Revenues, below, for further explanation of the replacement procedure.)

Explanation of State Revenues: The bill would eliminate revenue from the Inheritance Tax and could potentially lead to an increase in revenue from the Indiana Estate Tax until FY 2007. This offset by the Estate Tax will decline to zero by FY 2007 due to increases in the federal unified credit and the phase-out of the federal state death tax credit. (Note: Consistent with federal changes, the bill effectively eliminates the Indiana Estate Tax beginning with 2005 decedents.) The estimated impact of the bill on Inheritance Tax and Estate Tax revenue and the net loss to the state including county replacement funding is presented the table below. The estimates are based on the Revenue Technical Committee's updated FY 2003 forecast for the Inheritance and Estate Taxes. They assume that Inheritance Tax revenue will remain the same in subsequent years but make adjustments to forecasted Estate Taxes to account for the elimination of the Indiana Estate Tax in concert with the repeal of the state death tax credit under the federal Estate Tax. The estimates will be updated once a FY 2004 forecast is available.

Fiscal Year	Inheritance Tax Revenues	Estate Tax Revenues	State Expenditures for County Replacement	Net Increase (Decrease)
2004	(\$131.7 M)	\$30.7 M	(\$7.5 M)	(\$108.4 M)
2005	(\$131.7 M)	\$19.1 M	(\$7.5 M)	(\$120.0 M)
2006	(\$131.7 M)	\$5.9 M	(\$7.5 M)	(\$133.2 M)
2007 and after	(\$131.7 M)	\$0	(\$7.5 M)	(\$139.1 M)

Background on Inheritance Tax: The bill would eliminate the Inheritance Tax beginning with transfers from persons who die after June 30, 2002. Since the Inheritance Tax does not have to be paid until a maximum of 12 months after the decedent's death (within 9 months of the date of death to receive the 5% early payment discount), the impact of eliminating the tax likely would not be experienced until FY 2004.

The estimated revenue loss is based on the Revenue Technical Committee's updated FY 2003 forecast for the Inheritance Tax equal to \$160 M and assumes that revenue in subsequent years will remain the same. The forecast total includes revenue from the Indiana Estate Tax. Based on FY 2001 collections, roughly 17.7% of this total is derived from the Estate Tax. This suggests that Inheritance Tax revenue is forecast at approximately \$131.7 M and Estate Tax revenue at about \$28.3 M. Thus, the Inheritance Tax revenue loss for FY 2004 and after is estimated to be \$131.7 M.

Background on Estate Tax: The elimination of Inheritance Tax liabilities could potentially have an impact on Indiana Estate Tax revenues. Indiana Estate Tax is owed on the assets of an estate if (1) federal Estate Tax is owed on the estate and (2) the Indiana portion of the federal state death tax credit (against the federal Estate Tax) exceeds the total Inheritance Tax paid by transferees of the estate. Since the Inheritance Tax is eliminated, the Estate Tax liability would be equal to the Indiana portion of the state death tax credit. The bill reflects this change. Consequently, for estates that owe federal Estate Tax, the elimination of the Inheritance Tax liability for transferees of the estate results in a compensating increase in the Estate Tax liability.

The estimated impact of the bill on Estate Tax revenues is based on an OFMA database of Estate Tax returns relating to decedents who died between July 1, 1997, and June 30, 2000. The database consists of 559 estates upon which Indiana Estate Tax was paid. Elimination of the Inheritance Tax liability for the sample increased

the Estate Tax liability of the sample by a factor of approximately 4.9 for FY 2004, 7.2 for FY 2005, and 8.1 for FY 2006. Based on the updated FY 2003 forecast and accounting for the impact of the recent federal Estate Tax changes, Indiana Estate Tax revenues are estimated to be about \$7.97 M in FY 2004, \$3.1 M in FY 2005 and \$840,000 in FY 2006. The recent federal law changes accelerate the scheduled increase in the unified credit and begin phasing out the state death tax credit in 2002. These estimates are increased by the factors specified above to derive the impact of the Inheritance Tax changes on the Estate Tax.

Explanation of Local Expenditures:

Explanation of Local Revenues: The repeal of the Inheritance Tax is estimated to result in an annual net revenue loss to counties of \$3.9 M statewide beginning in FY 2004. The annual impact beginning in FY 2004 is summarized in the table below.

	Annual Impact Beginning in FY 2004
Inheritance Tax Revenues	(\$11.4 M)
State Expenditures for County Replacement	\$7.5 M
Net Increase (Decrease)	(\$3.9 M)

Counties retain 8% of the Inheritance Tax collected on transfers made by Indiana residents. The repeal of the Inheritance Tax is estimated to reduce county Inheritance Tax collections by approximately \$11.4 M. This is based on the Revenue Technical Committee's updated FY 2003 forecast for the Inheritance Tax and assumes that revenue will remain the same in subsequent years. The estimates will be updated once a FY 2004 forecast is available. It is important to note that a reduction in the amount of Inheritance Tax retained by counties due to the bill may be reimbursed by the state under the replacement provision established by P.L. 254-1997. The table also specifies the amount of replacement funding the counties will receive beginning in FY 2004. The replacement provision was established when the Class A exemption was increased on July 1, 1997. The replacement provision guarantees that in each fiscal year each county receives an amount under the Inheritance Tax that is equal to the five-year annual average amount of Inheritance Tax revenue retained by that county from FY 1991 to FY 1997, excluding the highest and lowest year. The maximum amount of county replacement for any year is approximately \$7.5 M. A copy of a spreadsheet showing the amount of Inheritance Tax replacement guaranteed to each county under P.L. 254-1997 is available from the Office of Fiscal and Management Analysis.

State Agencies Affected: Department of State Revenue.

Local Agencies Affected: Counties.

Information Sources: State Revenue Forecast, April 12, 2001; Bill Reynolds, Indiana Department of State Revenue, 232-2075; OFMA Inheritance and Estate Tax Databases; OFMA County Replacement Spreadsheet.